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October 2, 2011

Dr. George Diehr
Chair of the Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Global Equity – Annual Program Review and External Manager Contract Renewals¹

Dear Dr. Diehr:

You requested Wilshire's opinion with respect to the Global Equity Annual Program Review and Staff's proposal to extend the contracts of the existing external global equity managers.

Overview and Recommendation

Wilshire believes the Global Equity program is well managed and is an appropriate implementation approach for CalPERS' public equity portfolio. While Staff continues to refine the holistic approach to public equity investing, we believe that the process has provided more rigor to the portfolio construction process and serves as a guidepost to Staff when considering how to continue to improve the structure of the Global Equity portfolio.

Furthermore, we recommend that the Investment Committee extend all of the manager contracts as Staff has requested. Our rationale is detailed below.

Background

The Global Equity Program is designed to provide expansive exposure to the world equity markets, seeking to add value in a risk controlled manner. Wilshire monitors and

¹ Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover.



conducts annual reviews on each of the internal components (internally managed strategies and the Corporate Governance Investment Program) and monitors and conducts regular ongoing due diligence of the external equity managers. While each of these components is critical, this agenda item allows Wilshire the chance to formally opine on the total program.

As we noted in the Overview, we believe that the Global Equity Program is an appropriate implementation approach for CalPERS. Given CalPERS' size and the nature of the active risk in other asset classes, a broad-based, largely passive approach is prudent, effective, and efficient. While CalPERS' size often acts as a limiting factor in the pursuit of active returns, the scale of the portfolio forces CalPERS to be both a long term equity owner and a low cost trader when portfolio transactions are required.

The most significant change to the Global Equity Program from last year is that the Absolute Return Strategies Program no longer resides within the Global Equity Program. We have provided our annual review of the ARS Program in a separate agenda item. While this separation of duties makes sense long term, the departure of the SPM that managed the ARS program is some cause for concern. Our ARS Program Annual Review discusses this in greater detail and provides our rationale for temporarily moving the control of the ARS Program back to Global Equity.

With respect to the Global Equity portfolio, Staff has worked diligently over the past several years to develop and implement a holistic approach to allocating capital among the various programs. Staff continues to refine this approach and it will be a process of continual evolution. This approach uses both quantitative and qualitative analyses to review existing or potential strategies to measure the impact on the estimated risk and return of the Global Equity portfolio.

The quantitative approach easily deals with the internal and traditional external strategies. As we have noted in the past, the lumpy return behavior of the Corporate Governance Investment Program makes quantitative modeling more challenging. Staff is continuing to work on ways to incorporate the excess returns driven by CalPERS Corporate Governance efforts (both internal and external) into the quantitative model.

Staff continues to make changes to the external manager lineup as warranted, adding to managers who help the portfolio meet its goals or removing managers who provide little to no benefit to the overall portfolio. The existing external managers have been fully vetted using the new framework and each play a role. In addition, Wilshire consistently monitors all of CalPERS external equity managers, acting as the Investment Committee's advocate.

In recognition of the different roles that each manager plays in the total Global Equity Program, Wilshire recommends that the Investment Committee renew each contract as Staff has proposed. We consider each to have the appropriate characteristics to remain



one of CalPERS external managers – a stable organization, an appropriate and unique investment process that plays a role in the total Global Equity program, and returns that demonstrate a long term ability to add value to CalPERS total Global Equity portfolio. As always, CalPERS has the right to terminate any of these managers on no more than 30 days notice, should the need arise.

In the past year, the Investment Committee has granted Staff the ability to seek new managers without the cumbersome RFP process. This will allow Staff to more easily target managers or groups of manager to play specific roles in the portfolio and to add managers more quickly. However, Staff has not, as yet, used these new abilities to add managers to the portfolio.

Staff has introduced a new internally managed strategy into the portfolio over the last year. The Fan Long Only strategy was managed internally within the Global Equity Developmental Fund for some time before Staff proposed graduation and the ability to provide higher levels of funding to that strategy. Wilshire believes that finding new strategies that can be managed internally serves CalPERS well. These strategies take advantage of the Staff's portfolio construction and trading background and make use of CalPERS scale. To date, the strategies have not required significant Staff resources for non-trading activities as Staff has generally partnered with outside organizations to act as CalPERS' research and development arm.

Conclusion

Wilshire views the progress of the Global Equity Program favorably. Staff has fully implemented the holistic capital allocation process and Wilshire believes that this framework is working well and acts as a guidepost for Staff when making changes to the portfolio. Wilshire recommends the extension of contracts for the current managers as part of the overall portfolio.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,